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[redacted]

[redacted] COMPANY, as trustee in Bankruptcy of [redacted] Realty Co., Inc., a Delaware corporation,

Petitioner,

—against—

A. W. PERRY, INC., a Massachusetts corporation,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT AND BRIEF IN SUPPORT THEREOF.

[redacted]

CHARLES K. BIRKMAN,
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1933.

IRVING TRUST COMPANY, as Trustee in Bankruptcy of Outfitters Operating Realty Co., Inc., a Delaware corporation,

Petitioner,

—against—

A. W. PERRY, INC., a Massachusetts corporation,

Respondent.

Petition for Writ of Certiorari.

To the Honorables, The Chief Justice of the United States and the Associate Justices of the Supreme Court of the United States:

Your petitioner respectfully submits its petition for a writ of certiorari to review the decision of the Circuit Court of Appeals for the Second Circuit in the above case.

Summary Statement of the Matter Involved.

In 1929 the respondent, A. W. Perry, Inc., leased to the bankrupt corporation, Outfitters Operating Realty Co., Inc., certain premises at No. 459 Washington Street, Boston, Massachusetts, for a term ending December 31, 1945, at a rental starting at the rate of $35,000 per annum for the first ten (10) months, and progressing to the rate of $39,805.00 per annum for the latter years of the demise, plus certain other charges therein specified (R. 11-12).

The lease contained the following provision (R. 16-17):

> "* * * and, for the more effectual securing to the Lessor of the rent and other payments herein provided, it is agreed as a further condition of this lease that the filing of any petition in bankruptcy or insolvency by or against the Lessee shall be deemed to constitute a breach of this lease, and thereupon, *ipso facto* and without entry or other action by the Lessor, this lease shall become and be terminated; and, notwithstanding any other provisions of this lease, the Lessor shall forthwith upon such termination be entitled to recover damages for such breach in an amount equal to the amount of the rent reserved in this lease for the residue of the term hereof less the fair rental value of the premises for the residue of said term."

The bankrupt filed a voluntary petition in bankruptcy in the United States District Court for the Southern District of New York on September 30, 1932, and was adjudicated a bankrupt on that date (R. 1).

The respondent filed a claim in the bankruptcy proceeding for $177,788.00, claiming that amount to be its so-called damages to which it was entitled under the provision of the lease above set forth, although the proof of claim affords no explanation of the computation (R. 8).

The claim was expunged by Referee Kurtz (R. 23-36, 37-38), whose order was affirmed by the District Court (Goddard, *J.*) (R. 43, 44-45).

The orders of the Referee and of the District Court were, however, reversed by the Circuit Court of Appeals with an opinion by L. Hand, *J.* (R. 52-55) in which it was said that the decision of this Court in *Manhattan Properties, Inc.* v. *Irving Trust Company,* 54 S. Ct. Rep. 385, finally determined that claims for future rent are ordinarily not provable "and can become so, if at all, only by virtue of

special clauses"; that the question in this case presented was whether the instant clause would serve; that the possible validity of the instant clause "was specifically reserved" in this Court's opinion in the *Manhattan Properties* case; that while the rule of damages specified in said clause, in the absence of a specific covenant by the parties therefor, would not be acceptable in bankruptcy, the express promise of the lessee in the lease to pay such damages is lawful and gives rise to a provable claim; but that, to avoid the possibility of the promise here made constituting a penalty, it was to be interpreted as providing for the discounting of the minuend, *i. e.*, the rent reserved for the residue of the term. The Circuit Court of Appeals thereupon held that the claim was provable, interpreting the lease as providing for "the sum of the discounted series of instalments, each made up of the rent reserved, less the fair rental value for that period."

Questions Presented.

A.—Can a landlord and tenant turn an otherwise non-provable claim into a provable claim merely by stipulating that, in the event of the bankruptcy of the tenant, the lease shall *ipso facto* terminate and the tenant thereupon be liable to pay liquidated damages?

B.—Assuming that such a stipulation may give rise to a provable claim, is a promise by the lessee to pay as such liquidated damages an amount equal to the rent reserved in the lease for the residue of the term, less the fair rental value of the premises for the residue of the term, nevertheless unenforceable as a penalty and for uncertainty.

Reasons Relied on for Allowance of the Writ.

1. The first question here presented is fundamental and has never been expressly decided by this Court.

In *Manhattan Properties, Inc.* v. *Irving Trust Co., supra,* this Court determined (a) that claims for future rent as such are not provable in bankruptcy; and (b) that covenants of indemnification of the landlord, dependent upon re-entry by the landlord subsequent to the filing of the petition in bankruptcy, do not give rise to provable claims in bankruptcy inasmuch as the landlord must initiate a new contract of indemnity by the affirmative step of re-entry necessarily occurring subsequent to the filing of the petition.

While the *Manhattan Properties* decision disposed of the uncertainty theretofore existing with respect to claims for future rent and indemnity provisions effective after the date of petition filed, there remains undetermined, as a matter of explicit decision, the question as to whether a landlord may nevertheless *create* a provable claim by the device of an express agreement for damages effective by virtue of a termination of the lease automatically resulting from the filing of the petition in bankruptcy.

2. The court below, against the trend of this Court's decisions, has sanctioned this device.

In doing so it has disregarded the following language in the *Manhattan Properties* decision (pp. 387, 388):

> "The courts uniformly held (under the Act of 1867) that claims for future rent or *for damages for breach of covenant to pay rent* were not provable under the act, though differing as to the reason; some holding them not contingent claims within the statutory definition, and others thinking the ex-

> press permission of proof for rent past due at the date of bankruptcy impliedly excluded claims for rent thereafter falling due. * * * In view of the extended consideration and discussion which preceded the passage of the Act (of 1898), the failure to include a provision for claims for loss of rent or *for damages consequent on the abrogation of leases,* is significant of an intent not to depart from the precedents disallowing them." (Italics and parenthetical references ours.)

The court below reached its result by an attempted distinction between the situations arising upon leases containing no covenant for damages, and where, as here, such a covenant is expressed. Even though the measure of damages to be applied might be the same, the court below conceived it as merely a forecast in the former situation, adding that "a forecast in these circumstances will not do for bankruptcy, which is more rigid as to such issues than other proceedings, an action at law, for example." In the latter instance, *i. e.,* where there is an express covenant, the opinion below characterizes it as a promise "which does not look to the future, which is to pay the difference between two amounts presently ascertainable" (R. 54).

The attempted distinction means nothing except that a non-provable claim may be turned into a provable one simply by the *making of the promise.*

To be sure, in *William Filene's Sons Co.* v. *Weed,* 245 U. S. 597, 602, an express covenant for damages was approved because there was a promise, and in *Gardiner* v. *Butler & Co.,* 245 U. S. 603, disapproved because there was no promise.

Both of the cases mentioned, however, arose in *equity,* thus presenting an all important distinction between the situation there at bar and the instant controversy. The

distinction is not ours, but was made by this Court itself in the *Weed* case, when it said (pp. 601-602):

> "When a statutory system is administered the only question for the courts is what the statutes prescribe. But when the courts *without statute* take possession of all the assets of a corporation under a bill like the present and so make it impossible to collect debts except from the court's hands, they have no warrant for excluding creditors, or for introducing supposed equities other than those *determined by the contracts that the debtor was content to make and the creditors to accept.*" (Italics ours.)

The absence or the presence of the promise was material only because the proceeding was in equity.

Two years prior to the *Weed* case this Court, in *Central Trust Co.* v. *Chicago Auditorium Association,* 240 U. S. 581, which arose in a bankruptcy proceeding, held provable a claim for similar damages with respect to a contract for the baggage and livery privilege of the Auditorium Hotel in Chicago, which contained no covenant for liquidation of damages. This Court held that the bankruptcy constituted an anticipatory breach, but pointed out that the situation was to be distinguished from cases arising out of the relation of landlord and tenant, "because of the 'diversity betweene duties which touch the realty and the meere personalty' ", a distinction again made in *Maynard* v. *Elliott,* 283 U. S. 273, at 278.

These cases clearly indicate the trend of this Court's decisions. In bankruptcy it has recognized that damage claims arising from the relationship between landlord and tenant stand apart. In equity only has it rendered effective express covenants in leases to pay such damages, because there the courts, taking possession of the defendant's assets without statute, have no warrant to do otherwise.

3. The decision below has therefore created an exception which points the way to evasion of the long established rule.

If landlords, who may not prove for rent, may still prove for damages for its loss by mere recourse to express covenants, leases to corporate tenants will be written with the instant clause substantially incorporated. Landlords will be insistent, particularly in the case of long term leases at high rentals. Corporate tenants will be acquiescent, in the realization that not they but their bankrupt estates will bear the burden of the promise (See *Kothe* v. *R. C. Taylor Trust,* 280 U. S. 224, 226).

Whether or not such an exception is to be engrafted upon the rule will not be definitely known until this Court has spoken. No certainty can be achieved short of its decision, and yet such certainty is of the utmost importance. The question is of course of substance in the instant case because of the length of the term and the amount of the rent reserved. It is of infinitely greater importance to the business world at large as a guide to the future.

If the decision below is correct, banks, manufacturers, merchants and others extending credit will be forced to take into consideration, particularly in the case of long term leases, the probability of having to compete with claims of overwhelming size. If it is not correct this credit menace should be speedily eliminated by finally authoritative decision.

4. Moreover, there is conflict with applicable decisions of this Court in another material aspect, for the express promise here contained sounds as a *penalty* rather than as a promise to pay liquidated damages.

The court below was sensible of this difficulty, for it said (R. 54):

"* * * but there is one doubt that does arise:

> whether the clause is for a penalty because the future payments are not discounted to their present values. If the lessee must pay at once the sum of a series of instalments, each consisting of the difference between the rent reserved on successive rent days, and the estimated rent which will have been received on those days, the recovery will surely be more than compensatory. The present value of such an instalment, payable twenty years hence, is very much less than its face."

The opinion then refers to this Court's decision in *Kothe* v. *R. C. Taylor Trust, supra,* in which a clause verbatim with that at bar (save for the subtrahend) was condemned as an unenforcible penalty, whose real design "was to insure to the lessor preferential treatment in the event of bankruptcy."*

The *Kothe* case dealt with a lease, which had but fifteen months to run, and yet the provision for damages in the amount of the rent for those fifteen months was held to be "disproportionate to any damage reasonably to be anticipated in the circumstances disclosed."** Here the lease at the time of bankruptcy had upwards of twelve years to run.

The decision below sought to avoid the result in the *Kothe* case by interpreting into the language of the instant clause a discount provision, the lease being thus allegedly construed in accordance with what the court below conceived to be "its patent general purpose to give the lessor indemnity, and no more" (R. 55).

This Court did not attempt such a construction in the Kothe case, but condemned the clause as it was written. Nevertheless the court below supplemented the language of the lease at bar so as to hold that the proper measure of damages under the terms was "the sum of the *discounted*

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* 280 U. S., at 227.
** 280 U. S., at 226.

series of instalments, each made up of the rent reserved, less the fair rental value for that period" (R. 55).

In *Hermitage Co.* v. *Levine,* 248 N. Y. 333, Mr. Justice (then Chief Judge) Cardozo said of the damage clause there involved:

> "If the damage clause as drawn gives inadequate protection, the fault is with the draftsman. The courts are not at liberty to supply its omissions at the expense of a tenant whose liability for the future ended with the cancellation of the lease, except insofar as he bound himself by covenant to liability thereafter."

That language is applicable with even more force here, where the liability is that of the bankrupt's estate rather than of the tenant, and where there are to be considered the interests of creditors rather than those of the tenant who made the promise.

5. In *William Filene's Sons Co.* v. *Weed, supra,* the subtrahend of the formula was the "rental value at the date of entry," a figure reasonably susceptible of determination because predicated upon a date approximately at hand. Such is not the subtrahend provided in the clause at bar, where there is to be subtracted from the discounted instalments of rent reserved "the fair rental value of the premises for the residue of said term."

This must mean that the rental value is to be determined as of the due date of each of the several instalments of rent. Month by month in the years the lease has to run, the rental value must be sought for. Conjecture and speculation must be given fullest rein.

Moreover, in determining the fair rental there must be taken into consideration that under the lease itself there may be no rental value in certain contingencies.

The lease itself expressly provides (R., pp. 15, 11) that in the event of fire which destroys the entire premises so that the lessor's over-lease is cancelled, or in the event of the destruction of the whole or any part of the building by any other unavoidable casualty, or in the event that the premises are taken by public authority for public purpose, the lessor may terminate the lease; but in any event upon the happening of any such contingency the rent is to be suspended or abated until the premises are rehabilitated. These contingencies affect vitally the question not only of the amount, but of the very existence of any damage to the landlord, and yet, whether or not any of them may happen during the twelve year balance of the term, it is impossible to forecast. (Compare *Dunbar* v. *Dunbar,* 190 U. S. 340, 345.)

Such a subtrahend would appear to fall precisely within the condemnation of this Court in *Maynard* v. *Elliott, supra,* when it said at page 278:

> "Or, the contingency may be such as to make any valuation of the claim impossible even though liability has attached."

Therefore again is presented a result in conflict with an applicable decision of this Court.

6. This case presents both principal problems that may arise in respect of an *ipso facto,* self-executing clause for damages in a real estate lease, *i. e.,* whether it is a permissible device to give rise to a provable claim, and, if so, what circumscription should be written to avoid the faults of penalty, conjecture and uncertainty.

We believe that we are not unjustified in saying that, in the absence of the disposition of the matter by this Court, the problems here raised will continue to plague the business world with increasing pressure, because of the weight which the decision below will necessarily carry. However, the problem is even now a pressing one, as the instant case

is not a solitary example of the type of clause here at bar. We are informed that in the bankruptcy proceedings of the Louis K. Liggett Company there are pending four similar cases in the United States District Court for the Southern District of New York and in the Circuit Court of Appeals for the Second Circuit, in which are involved claims aggregating $399,765.34, upon which it is anticipated dividends will be payable, if the claims are not expunged, in an amount in excess of $200,000.

By exercising jurisdiction in this case, the Court presumably will be able to dispose of the entire subject. To do so will be to supply certainty where uncertainty has arisen, facilitate the expeditious disposition of bankruptcies now pending, and guide the business world, bench and bar for the future.

WHEREFORE, your petitioner respectfully prays that a writ of certiorari be issued out of and under the seal of this Honorable Court, directed to the United States Circuit Court of Appeals for the Second Circuit, commanding that court to certify to and send to this Court for its review and determination, on a day certain to be therein named, a full and complete transcript of the record and all proceedings in the case numbered and entitled on its docket No. 201, in re Outfitters Operating Realty Co., Inc. (a Delaware corporation), Bankrupt, A. W. Perry, Inc., Appellant, against Irving Trust Company, Trustee, Appellee, and that the said decree of the said Circuit Court of Appeals for the Second Circuit may be reversed by this Honorable Court, and that your petitioner may have such other and further relief in the premises as to this Honorable Court may seem meet and just; and your petitioner will ever pray.

IRVING TRUST COMPANY, as Trustee in Bankruptcy of Outfitters Operating Realty Co., Inc., a Delaware corporation,

Petitioner,

By CHARLES K. BEEKMAN,
EDWARD K. HANLON,
Counsel for Petitioner.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1933.

IRVING TRUST COMPANY, as Trustee in Bankruptcy of Outfitters Operating Realty Co., Inc., a Delaware corporation,

Petitioner,

—against—

A. W. PERRY, INC., a Massachusetts corporation,

Respondent.

BRIEF IN SUPPORT OF PETITION.

Opinions Below.

The opinion of the Referee (R. 23-36) is not reported in the Federal Reporter or Supplement.

The opinion of the District Court (per Goddard, *J.*) (R. 43) is not reported in the Federal Reporter or Supplement.

The opinion of the Circuit Court of Appeals (R. 52-55) is reported at 69 F (2d) 90.

Jurisdiction.

The decree of the Circuit Court of Appeals for the Second Circuit, sought to be reviewed, was entered on February 20th, 1934 (R. 55-56).

The jurisdiction of this Court is invoked under Section 240-a of the Judicial Code, as amended by the Act of February 13, 1925 (U. S. C., Title 28, §347(a)).

Statement of Facts.

The facts have been stated in the petition.

Specification of Errors.

It is submitted that the court below erred:

(1) In reversing the decree of the District Court.

(2) In holding that the proof of claim of the respondent set forth a provable claim, and that it should be liquidated and allowed.

(3) In holding that a provision in a lease for real property, to the effect that in the event of the filing of a petition in bankruptcy by or against the lessee the lease should *ipso facto* terminate, and the lessee thereupon become liable to pay to the lessor damages in an amount equal to the amount of the rent reserved in the lease for the residue of the term, less the fair rental value of the premises for the residue of said term, gave rise to a provable claim in bankruptcy.

(4) In holding that such provision gave rise to a provable claim in bankruptcy notwithstanding the decision of this Court in *Manhattan Properties, Inc.* v. *Irving Trust Company,* 54 Sup. Ct. Rep. 385, inasmuch as it is for damages for breach of a covenant to pay rent.

(5) In holding that such provision gave rise to a provable claim in bankruptcy notwithstanding the decision of this Court in *Kothe* v. *R. C. Taylor Trust,* 280 U. S. 224, inasmuch as the minuend clause of the formula there set forth sounds in penalty.

(6) In holding that such provision gave rise to a provable claim in bankruptcy notwithstanding the decision of this Court in *Maynard* v. *Elliott,* 283 U. S. 273, inasmuch as the subtrahend clause of the formula there set forth is such as to render valuation impossible.

Statute Involved.

Section 63 of the Bankruptcy Act provides:

> "Debts which may be proved. (a) Debts of the bankrupt may be proved and allowed against his estate which are (1) a fixed liability, as evidenced by a judgment or an instrument in writing, absolutely owing at the time of the filing of the petition against him, whether then payable or not, with any interest thereon which would have been recoverable at that date or with a rebate of interest upon such as were not then payable and did not bear interest; * * * (4) founded upon an open account, or upon a contract express or implied; * * *.
>
> "(b) Unliquidated claims against the bankrupt may, pursuant to application to the court, be liquidated in such manner as it shall direct, and may thereafter be proved and allowed against his estate."

Section 1 (11) provides:

> "'debt' shall include any debt, demand or claim provable in bankruptcy";

Section 17 provides:

> "A discharge in bankruptcy shall release a bankrupt from all of his provable debts * * *" with exceptions not here material.

(Act of July 1, 1898, Sections 1, 17 and 63, 30 Stat. 562, as amended; U. S. C., Title 11, Sections 1, 35 and 103.)

Summary of Argument.

I.

The long established rule that claims for rent and for damages for breach of rent covenants are not provable in bankruptcy, is not to be avoided by mere resort to an express agreement in the lease to pay liquidated damages upon a stipulated *ipso facto* termination of the lease on the filing of a petition in bankruptcy by or against the tenant.

(A) The rationale of the opinion below is based upon the solitary circumstance of an express agreement to pay such damages.

(B) An exception to the general rule based upon such a consideration finds no justification in the trend of judicial decision, but is in fact contrary to it.

(C) Nor is there any logical reason why the inclusion of an express covenant should create an exception to the general rule.

II.

Even assuming that a landlord and tenant may turn an otherwise non-provable claim into a provable claim by the device of stipulating that, in the event of the filing of a petition in bankruptcy by or against the tenant, the lease shall *ipso facto* terminate and the tenant thereupon be liable to pay liquidated damages, the instant clause would not in any event give rise to a provable claim because

(A) The minuend clause sounds in penalty rather than liquidated damages; and

(B) The subtrahend clause renders valuation impossible, since (a) it involves a month to month inquiry for the balance of the term as to the rental

value on each of the stipulated rental dates, and (b) impossibility of valuation also ensues because of the provisions of the lease with respect to the termination and abatement of rent in certain contingencies.

Argument.

I.

The long established rule that claims for rent or damages for breach of rent covenants are not provable in bankruptcy is not to be avoided by mere resort to express agreement to pay liquidated damages upon a stipulated *ipso facto* termination of the lease on the filing of a petition in bankruptcy by or against the tenant.

Pointing out that under the Act of 1867 the courts uniformly held that "claims for future rent or for *damages for breach of covenants to pay rent* were *not provable*",* and that, in view of the extended consideration and discussion which preceded the passage of the Act of 1898, "the failure to include a provision for claims for loss of rent or for *damages consequent on the abrogation of leases* is significant of an intent *not* to depart from the precedents disallowing them", this Court said in *Manhattan Properties, Inc.* v. *Irving Trust Co.*, 54 Sup. Ct. Rep. 385, 388:

> "In this situation 'only compelling language in the statute itself would warrant the rejection of a construction so long and so generally accepted'."

We may therefore properly conclude that by the *Manhattan Properties* decision this Court intended to determine that claims for loss of rent and claims for damages for

* Italics by counsel unless otherwise stated.

breach of covenants to pay rent are not provable under the Act.

Yet although this Court's decision in the *Manhattan Properties* case contained no expression of belief that the rule permitted of exception, in the instant case the court below has held that damages for breach of a covenant to pay rent *are* provable where the lessee has expressly agreed to pay them upon a stipulated *ipso facto* termination of the lease on the filing of a petition in bankruptcy by or against the tenant.

In the opinion below the court remarks (R. 53) that the instant situation was "specifically reserved" by this Court in the *Manhattan Properties* decision. This misapprehension was due to the failure to observe that the reference in the *Manhattan Properties* decision (at p. 389) to the instant situation was solely in response to a contention raised by the petitioners in that case, and not intended to be expressive of an exception.

That the court below is still in grave doubt as to the correctness of the result in the instant case, is apparent from the following comment in its opinion in *Wright* v. *Irving Trust Company* (not yet reported), a case decided subsequently to that at bar, where the same judge who wrote the opinion below said, in speaking of the *Manhattan Properties* decision:

> "As we understand it, the invalidity of rent claims is not deduced from the statute, but is a historical exception; the earlier acts by judicial construction had refused to allow claims for future rents, even when contingent claims were provable; although such claims are now generally provable, not only did Congress fail to include rents in 1898, but it continued inert through many amendments, in spite of a number of decisions in accord with the earlier interpretation. *It is not altogether plain how we ought*

> *to circumscribe such a doctrine; how far it should be limited to the occasions which have heretofore arisen; how far we should rationalize it in the interest of convenience in application."*

It might be fairly said that there is nothing in the decisions of this Court which justifies the suggestion that the doctrine with respect to rent claims ought to be circumscribed in any fashion.

Yet here the circumscription sought to be effected arises, not from any variation in the subject matter, but by reason merely of an express agreement between the parties. If such a principle is to be established there appears no reason why the corollary should not also be true, *i. e.*, that parties may stipulate as to what claims will *not* be provable in bankruptcy, and therefore not dischargeable.

A.—*The Rationale of the Opinion Below Is Based Upon the Solitary Circumstance of an Express Agreement to Pay Damages.*

The court below recognized that the measure of damages provided for in this lease would be unacceptable in the absence of an express covenant therefor, since it would be "only a forecast, and a forecast in these circumstances will not do for bankruptcy, which is more rigid as to such issues than other proceedings, an action at law for example". The court then said (R. 54):

> "But when the parties have agreed that the lessee shall pay a sum to be ascertained by an accessible standard, the bankruptcy court is not liquidating a future loss at all; in its place the parties have substituted a promise, which does not look to the future, which is to pay the difference between two amounts presently ascertainable. *The only question is whether that promise is lawful,* whether it makes a contract, and as to that we have it on the highest authority

> that it liquidates 'the damages upon a footing familiar and fair'. *Filene's Sons* v. *Weed*, 245 U. S. 597, 602."

In other words, the measure of damages here provided only became acceptable to the court below by virtue of its definite expression in the lease.

B.—*Such an Exception Finds No Justification in the Trend of Judicial Decision, but Is in Fact Contrary to It.*

Certainly such a novel doctrine finds no warrant in the statute, and the court below cites no judicial authority in its support.

This Court has not expressly passed upon the question. Two lower Federal courts have.

That an express covenant will not create an exception in a rent case was the holding in *Matter of Bliss Auto Sales Company*, 224 A. B. R., N. S., 44 (not officially reported; D. C., N. D. of Ohio, W. D.). Such was also the result in *Wells* v. *Twenty-First Street Realty Co.*, 12 F. (2d) 237 (C. C. A., 6th Circ.), as appears from the provisions of the lease there at bar, which are to be found in the report of that case in the District Court, *sub nom. In re Bissinger & Co.*, 5 F. (2d) 106.

We assume that, strictly speaking, the *Manhattan Properties* decision must be confined to the precise problem there before the Court, which had to do with claims for future rent and indemnification clauses effective only after petition filed. The philosophy of that decision, however, is clearly applicable to the general trend of judicial thought, which has been condemnatory of all claims for damages arising out of rent clauses.

The rule has not been confined, either in its direct expression or by implication, solely to cases of claims for future rent as such, but has embraced generally claims for *damages* arising out of covenants for the payment of rent.

Manhattan Properties, Inc. v. *Irving Trust Co., supra,* at 387, 388.

See also *Wells* v. *Twenty-First Street Realty Co., supra,* at page 238, where it was said:

> "The law seems to be well settled that, in states where the common law obtains, *a claim for damages for an anticipatory breach of a lease for real estate is not provable in bankruptcy.*"

Coordination of this doctrine to cases affecting personalty is futile, since the distinction is historical. As this Court said in *Gardiner* v. *Butler & Co.,* 245 U. S. 603, 605:

> "But the law as to leases is not a matter of logic *in vacuo;* it is a matter of history that has not forgotten Lord Coke."

There are four decisions of this Court strongly indicative of its opinion that claims for damages are as unacceptable as claims for future rent themselves.

In *Gardiner* v. *Butler & Co., supra,* an equity proceeding, this Court denied a claim for damages upon a basis somewhat similar to that at bar. (There the lease did not contain any clause providing for such damages.)

In *Wm. Filene's Sons & Co.* v. *Weed,* 245 U. S. 597, arising in the same equity receivership as the *Gardiner* case and the opinion being written by the same eminent jurist, there was an express covenant for the payment of damages, to wit, the difference between the rental value at the date of entry and the rent reserved. The claim was allowed, but the Court expressly pointed out (pp. 601, 602) that the case was to be distinguished from a bankruptcy proceeding, for the reason that, having taken possession of all of the assets of the corporation, not under

a statute but under a bill in equity, the courts "have no warrant for excluding creditors, or for introducing supposed equities other than those determined by the contracts that the debtor was content to make and the creditors to accept".

The conclusion is inescapable that a like result would not have been achieved in bankruptcy. Yet there was there an express covenant for the payment of such damages.

In *Central Trust Co.* v. *Chicago Auditorium Association*, 240 U. S. 581, a claim was held provable for similar damages with respect to a contract for the baggage and livery privilege of the Auditorium Hotel in Chicago. There the contract contained no express covenant for liquidation of damages. The Court, however, was careful to distinguish between that case and a case "arising out of the relation of landlord and tenant" (pp. 589-590).

Again, in *Maynard* v. *Elliott*, 283 U. S. 273, the Court sanctioned a claim against the bankrupt as an endorser upon certain notes not yet matured or dishonored, but again adverted to the fact that some contingent claims are deemed not provable, and cited as an example *Atkins* v. *Wilcox*, 105 Fed. 595, a claim for future rent.

These four decisions of this Court are all mutually consistent and may be rationalized as follows:

In equity proceedings the courts, not dealing with a statutory system but acting purely by virtue of their inherent chancery powers, must give effect to contracts as written by the parties.

In bankruptcy the court is dealing with a statutory system and can allow only such claims as the statute permits.

As a matter of historical distinction, sanctioned by

long legislative history, the statute generally permits proofs of claim for anticipatory breaches of contracts, but in respect of the relationship of landlord and tenant claims for rent and for damages for breach of covenants to pay rent are not provable.

In equity there may be a distinction between the making and the absence of a promise; in bankruptcy the distinction has to do with the *subject matter.*

For the sake of completeness, one word should be said with respect to the decision of this Court in *Kothe* v. *R. C. Taylor Trust,* 280 U. S. 224. In that case there was presented to the Court in a bankruptcy case a provision in a lease exactly like that at bar, with the exception that there was no subtrahend clause. The Court rejected the claim, treating the covenant as creating a penalty. That it did not advert to its provability generally as a matter of bankruptcy law can create no inference one way or another. That decision preceded the *Manhattan Properties* case, and there was no reason why the Court should then discuss the larger question of the provability of rent claims, which it had then not yet decided, in view of the simple fact that under no consideration could the claim there presented be allowed.

C.—*Nor Is There Any Logical Reason Why the Inclusion of an Express Covenant Should Create an Exception to the General Rule.*

Prior to the *Manhattan Properties* case a frequently ascribed reason for the principle denying the provability of rent claims was their contingency. *Atkins* v. *Wilcox,* 105 Fed. 595; *In re Roth & Appell,* 181 Fed. 667; and see *Maynard* v. *Elliott, supra,* at page 278.

The *Manhattan Properties* decision rests the doctrine upon historical grounds, the view thereafter taken by the court below in *Wright* v. *Irving Trust Company, supra.*

The fundamental basis, therefore, is an historical distinction between claims affecting landlord and tenant and those affecting other relationships. Under such circumstances there is no reasonable justification, nor can any possible basis be found in the historical sanction for the rule, for disregarding the peculiarities of the landlord and tenant relationship simply because recourse has been had to an express covenant. Adhesion to such a distinction would be so startling as to be justified only by the most cogent reasoning and statutory and judicial warrant. All are lacking.

II.

All other considerations apart, the instant clause would not in any event give rise to a provable claim.

We now assume, for the purposes of the instant discussion, that a landlord and tenant may turn an otherwise non-provable claim into a provable claim by the device of stipulating that, in the event of the bankruptcy of the bankrupt, the lease shall *ipso facto* terminate, and the tenant thereupon be liable to pay liquidated damages.

Even so postulated, the formula at bar is unacceptable as a basis for a provable claim in bankruptcy.

A. *The Minuend Clause Sounds in Penalty Rather than Liquidated Damages.*

In *Kothe* v. *R. C. Taylor Trust, supra,* this Court condemned a clause written (save for the absence of the subtrahend clause) in precisely the language of the clause here at bar. The clause there before the Court read (p. 225):

> "The filing of any petition in bankruptcy * * * by or against the Lessee shall be deemed to constitute a breach of this lease, and thereupon, *ipso facto*

and without entry or other action by the Lessor, this lease shall become and be terminated; and, notwithstanding any other provisions of this lease the Lessor shall forthwith upon such termination be entitled to recover damages for such breach in an amount equal to the amount of the rent reserved in this lease for the residue of the term hereof."

The Court said of that clause (pp. 226-227):

"The amount thus stipulated is so disproportionate to any damage reasonably to be anticipated in the circumstances disclosed that we must hold the provision is for an unenforceable penalty. The parties were consciously undertaking to contract for payment to be made out of the assets of a bankrupt estate—not for something which the lessee personally would be required to discharge. He, therefore, had little, if any, immediate concern with the amount of the claim to be presented; most probably, that would affect only those entitled to share in the proceeds of property beyond his control.

The broad purpose of the Bankruptcy Act is to bring about an equitable distribution of the bankrupt's estate among creditors holding just demands based upon adequate consideration. Any agreement which tends to defeat that beneficent design must be regarded with disfavor. Considering the time which the lease here involved had to run, nothing else appearing, it seems plain enough that the real design of the challenged provision was to insure to the lessor preferential treatment in the event of bankruptcy."

The court below was cognizant of this difficulty, for it said (R. 54):

"* * * but there is one doubt that does arise; whether the clause is for a penalty because the future payments are not discounted to their present values.

> If the lessee must pay at once the sum of a series of installments, each consisting of the difference between the rent reserved on successive rent days, and the estimated rent which will have been received on those days, *the recovery will surely be more than compensatory.* The present value of such an installment, payable twenty years hence, is very much less than its face."

The situation here is a more aggravated one than that before the court in the *Kothe* case, for here the lease had twelve years to run as against but fifteen months there. "Considering the time which the lease here involved had to run" (to use the words of the *Kothe* case), a minuend of *all* the rent reserved for the lengthy balance of the term constitutes even more clearly an amount "so disproportionate to any damage reasonably to be anticipated in the circumstances disclosed", that it should be held, as in that case, an unenforceable penalty.

It should also be borne in mind that the circumstance which gave rise to a so-called breach of the lease, and which involved this drastic formula for damages, bears no necessary reference to fault on the part of the tenant. An involuntary bankruptcy proceeding might be filed against the tenant and subsequently dismissed for lack of merit. The lease will, nevertheless, have come to an end, and the tenant be required to bear the burden of the formula.

To avoid the condemned result of penalty, the court below read into the minuend clause of the instant formula a provision for *discounting* the future rent reserved. Such an interpretation or construction of the language of the lease was not even attempted by this Court in the *Kothe* case. Yet the court below ventured to do so "to save the clause" (R. 55), a result which it is submitted the court was not free to reach, for, as Mr. Justice (then Chief

Judge) Cardozo said in *Hermitage* v. *Levine,* 248 N. Y. 333, 338:

> "If the damage clause as drawn is inadequate protection, the fault is with the draftsman. The courts are not at liberty to supply its omissions at the expense of a tenant whose liability for the future ended with the cancellation of the lease except in so far as he bound himself by covenant to liability thereafter."

B.—*The Subtrahend Clause Renders Valuation Impossible.*

In *Maynard* v. *Elliott, supra,* at page 278, the Court pointed out that not all contingent claims are provable, saying:

> "Or, the contingency may be such as to make any valuation of the claim impossible, *even though liability has attached.*"

The clause at bar provides that damages be computed in an amount "equal to the amount of the rent reserved in this lease for the residue of the term hereof *less the fair* [illegible] *for the residue of said term*".

1. *This involves a month by month inquiry for the balance of the term.*

If this subtrahend clause is to be interpreted as referring to the fair rental value as of the due date of each of the several instalments of rent, as would seem to be its meaning, the court will be projected into an inquiry which can only be resolved by the sheerest conjecture and speculation. The lease has twelve years to run. The rental is payable monthly (R. 12). Therefore, in computing the subtrahend of the formula it will be necessary to make inquiry as to value for each of the monthly rent days for the twelve years to come.

The difficulties of such an inquiry were well stated by the court below itself in its decision in *In re Metropolitan Stores, Inc.*, 66 F. (2d) 482, at page 484, where it was dealing with a claim for an anticipatory breach of a lease whose term had not begun at the date of petition filed. The court said (p. 484) that presumably the measure of damages would be "the difference between the rent stipulated in the lease and rent obtainable from other parties if the premises are re-let" (*i. e.*, the rental value). The court continued:

> "In the case at bar the original term was not to begin until January 1, 1935, and was to run for thirty years thereafter. Whether during that distinct period the landlord will profit or lose by reason of the prospective tenant's repudiation of his contract (assuming without decision that bankruptcy may be deemed such) *is pure speculation.*"

The application of such a formula readily seemed speculative to the court below where projected over thirty years. At bar it is only less so as a matter of degree. Valuation is impossible in either case, and hence in bankruptcy inacceptable.

2. *Impossibility of valuation also ensues because of the lease provisions for termination and abatement of rent.*

The fair rental value in the future cannot be estimated without also taking into consideration certain provisions of the lease under which there may be no rent to pay.

The lease provides (R. 15):

> "THIS LEASE IS MADE ON CONDITION that, in case the premises, or the estate of which they may form part, be in whole or part destroyed or damaged by fire, or other unavoidable casualty, or if said estate

be in whole or part taken by public authority for any public purpose, this lease may, at the election of the Lessor, be terminated; provided, that, if the same be not so terminated, a just and proportionate part of the rent shall be suspended or abated until the premises shall have been put by the Lessor in as good condition as at the date of such damage or taking; and the Lessee hereby assigns to the Lessor any and all claims and demands for damages on account of such taking."

Were we dealing with a provision for liquidated damages upon the basis of value at the date of petition filed, or date of entry (*cf. William Filene's Sons Co.* v. *Weed*, *supra*), this clause would be immaterial. In attempting, however, to estimate the fair rental value of the premises month by month as instalments become payable in the future, it is inevitable that there be taken into consideration the fact that the payment of rent may be suspended or abated under the terms of the lease by the happening of any one of the several eventualities in the paragraph above quoted. Yet to do so is manifestly to make impossible any valuation of the claim.

The situation is much akin to that in *Dunbar* v. *Dunbar*, 190 U. S. 340, where a claimant sought to prove against her bankrupt divorced husband upon an alimony agreement to pay her a stipulated sum "during her life, or until she marries". The Court remarked (p. 345):

"But how can any calculation be made in regard to the continuance of widowhood where there are no tables and no statistics by which to calculate such contingency? How can a valuation of a probable continuance of widowhood be made? Who can say what the probability of remarrying is in regard to any particular widow? We know what some of the factors might be in the question; inclination, age,

> health, property, attractiveness, children. These would at least enter into the question as to the probability of continuance of widowhood, and yet there are no statistics which can be gathered which would tend in the slightest degree to aid in the solving of the question."

Like methods of calculation here are wanting as to destruction, or damage by fire or other unavoidable casualty, or condemnation by public authority, so that any basic certitude upon which could be predicated computation cannot be resorted to.

C.—*Whether or Not the Claim Would Otherwise Be Provable, the Minuend Is Clearly Written in Terms of Penalty and the Subtrahend Presents a Method of Valuation Impossible of Pursuit. Either Consideration Renders the Claim Not Provable.*

CONCLUSION.

A writ of certiorari should be granted.

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